MONETARY POLICY STATEMENT

PRESS CONFERENCE

Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB

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Good afternoon, the Vice-President and I welcome you to our press conference. I would like to thank Governor Stournaras for his kind hospitality and express our special gratitude to his staff for the excellent organisation of today's meeting of the Governing Council.

The Governing Council today decided to keep the three key ECB interest rates unchanged. The incoming information has broadly confirmed our previous assessment of the medium-term inflation outlook. Inflation is still expected to stay too high for too long, and domestic price pressures remain strong. At the same time, inflation dropped markedly in September, including due to strong base effects, and most measures of underlying inflation have continued to ease. Our past interest rate increases continue to be transmitted forcefully into financing conditions. This is increasingly dampening demand and thereby helps push down inflation.

We are determined to ensure that inflation returns to our two per cent medium-term target in a timely manner. Based on our current assessment, we consider that the key ECB interest rates are at levels that, maintained for a sufficiently long duration, will make a substantial contribution to this goal. Our future decisions will ensure that our policy rates will be set at sufficiently restrictive levels for as long as necessary.

We will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction. In particular, our interest rate decisions will be based on our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission.

The decisions taken today are set out in a press release available on our website.

I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

Economic activity

The euro area economy remains weak. Recent information suggests that manufacturing output has continued to fall. Subdued foreign demand and tighter financing conditions are increasingly weighing on investment and consumer spending. The services sector is also weakening further. This is mainly because weaker industrial activity is spilling over to other sectors, the impetus from reopening effects is fading and the impact of higher interest rates is broadening. The economy is likely to remain weak for the remainder of this year. But as inflation falls further, household real incomes recover and the demand for euro area exports picks up, the economy should strengthen over the coming years.

Economic activity has so far been supported by the strength of the labour market. The unemployment rate stood at a historical low of 6.4 per cent in August. At the same time, there are signs that the labour market is weakening. Fewer new jobs are being created, including in services, consistent with the cooling economy gradually feeding through to employment.

As the energy crisis fades, governments should continue to roll back the related support measures. This is essential to avoid driving up medium-term inflationary pressures, which would otherwise call for even tighter monetary policy. Fiscal policies should be designed to make our economy more productive and to gradually bring down high public debt. Structural reforms and investments to enhance the euro area's supply capacity – which would be supported by the full implementation of the Next Generation EU programme – can help reduce price pressures in the medium term, while supporting the green and digital transitions. To that end, the reform of the EU's economic governance framework should be concluded before the end of this year and progress towards Capital Markets Union and the completion of Banking Union should be accelerated.

Inflation

Inflation dropped to 4.3 per cent in September, almost a full percentage point lower than its August level. In the near term, it is likely to come down further, as the sharp price increases in energy and food recorded in autumn 2022 will drop out of the yearly rates. September's decline was broad-based. Food price inflation slowed again, although it remains high by historical standards. In annual terms, energy prices fell by 4.6 per cent but, most recently, have risen again and become less predictable in view of the new geopolitical tensions.

Inflation excluding energy and food dropped to 4.5 per cent in September, from 5.3 per cent in August. This fall was supported by improving supply conditions, the pass-through of previous declines in energy prices, and the impact of tighter monetary policy on demand and corporate pricing power. Goods and services inflation rates fell substantially, to 4.1 per cent and 4.7 per cent respectively, with services inflation also being pulled down by pronounced base effects. Price pressures in tourism and travel appear to be moderating.

Most measures of underlying inflation continue to decline. At the same time, domestic price pressures are still strong, reflecting also the growing importance of rising wages. Measures of longer-term inflation expectations mostly stand around 2 per cent. Nonetheless, some indicators remain elevated and need to be monitored closely.

Risk assessment

The risks to economic growth remain tilted to the downside. Growth could be lower if the effects of monetary policy turn out stronger than expected. A weaker world economy would also weigh on growth. Russia's unjustified war against Ukraine and the tragic conflict triggered by the terrorist attacks in Israel are key sources of geopolitical risk. This may result in firms and households becoming less confident and more uncertain about the future, and dampen growth further. Conversely, growth could be higher than expected if the still resilient labour market and rising real incomes mean that people and businesses become more confident and spend more, or the world economy grows more strongly than expected.

Upside risks to inflation could come from higher energy and food costs. The heightened geopolitical tensions could drive up energy prices in the near term, while making the medium-term outlook more uncertain. Extreme weather, and the unfolding climate crisis more broadly, could push food prices up by more than expected. A lasting rise in inflation expectations above our target, or higher than anticipated increases in wages or profit margins, could also drive inflation higher, including over the medium term. By contrast, weaker demand – for example owing to a stronger transmission of monetary policy or a worsening of the economic environment in the rest of the world amid greater geopolitical risks – would ease price pressures, especially over the medium term.

Financial and monetary conditions

Longer-term interest rates have risen markedly since our last meeting, reflecting strong increases in other major economies. Our monetary policy continues to transmit strongly into broader financing conditions. Funding has become more expensive for banks, and interest rates for business loans and mortgages rose again in August, to 5.0 per cent and 3.9 per cent respectively.

Higher borrowing rates, with the associated cuts in investment plans and house purchases, led to a further sharp drop in credit demand in the third quarter, as reported in our latest bank lending survey. Moreover, credit standards for loans to firms and households tightened further. Banks are becoming more concerned about the risks faced by their customers and are less willing to take on risks themselves.

Against this background, credit dynamics have weakened further. The annual growth rate of loans to firms has dropped sharply, from 2.2 per cent in July to 0.7 per cent in August and 0.2 per cent in September. Loans to households remained subdued, with the growth rate slowing to 1.0 per cent in August and 0.8 per cent in September. Amid weak lending and the reduction in the Eurosystem balance sheet, the annual growth rate of M3 fell to -1.3 per cent in August – the lowest level recorded since the start of the euro – and still stood at -1.2 per cent in September.

Conclusion

The Governing Council today decided to keep the three key ECB interest rates unchanged. The incoming information has broadly confirmed our previous assessment of the medium-term inflation outlook. Inflation is still expected to stay too high for too long, and domestic price pressures remain strong. At the same time, inflation dropped markedly in September, including due to strong base effects, and most measures of underlying inflation have continued to ease. Our past interest rate increases continue to be transmitted forcefully into financing conditions. This is increasingly dampening demand and thereby helps push down inflation.

We are determined to ensure that inflation returns to our two per cent medium-term target in a timely manner. Based on our current assessment, we consider that rates are at levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to our target. Our future decisions will ensure that the key ECB interest rates will be set at sufficiently restrictive levels for as long as necessary to ensure such a timely return. We will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction.

In any case, we stand ready to adjust all of our instruments within our mandate to ensure that inflation returns to our medium-term target and to preserve the smooth functioning of monetary policy transmission.

We are now ready to take your questions.

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What role did the recent weak economic data and the war in Gaza play in today's discussion? And secondly, did you discuss or at least begin talking about ending PEPP reinvestment earlier or raising banks' reserve requirements?

Neither of these two questions, neither the PEPP, nor the remuneration of required reserves have been discussed at this meeting. You ask me about the current geopolitical environment and how that has weighed on our decision. I think we repeat two or three times in the context of this monetary policy statement the risks posed by the geopolitical environment and these aggravated risks as we see them unfold and develop. And of course, you have a special sentence in the monetary policy statement (MPS) that refers specifically, in addition to the totally unjustified war of Russia against Ukraine, to the tragic developments as a result of the terrorist attack on Israel. We are monitoring the situation. We are very attentive to the economic consequences that that could have, whether in terms of direct or indirect impact on energy prices, or the level of confidence that economic actors will continue to display.

I have two questions. I think on many peoples' minds is the question how long is actually "sufficiently long" and what will make you rethink and perhaps cut rates at one point in time? Is it at 2% inflation? Is it at 2.5? Is it at 3? I think that is something the market is interested in. My second question is on your comments about the yields, which are on the rise as well in the euro area and you said from other jurisdictions or from other regions, you are probably referring to the United States. Are you concerned about that rise in yields as well and also about the potential fragmentation here?

So how long is "sufficiently long"? Obviously, we refer to "timely manner", "sufficiently long", but in the same breath I say we shall be data dependent. At this point of our fight against inflation and after ten successive hikes, now is not the time for forward guidance. Now is the time to really stick to our data dependency 'knitting' if I may say and we shall do so. We have acknowledged on the occasion of this meeting that our assessment is confirmed, the assessment that we had in September. All numbers, if anything, have reinforced our assessment of the situation. We have applied the three criteria that you all know well; the inflation outlook, duly informed by any information that we have, the underlying inflation in all its compositions and the strength of the transmission of monetary policy. So, we will continue to be data dependent.

Your second question was essentially when and at what level do you cut? This was not discussed at all, and the debate would be absolutely premature. We have acknowledged in our review of the macroeconomic situation back in September and yet again this time around, and we all know, and you know, that labour cost, wages, profit units – the analysis of that – is critically important to determine the

inflation outlook. And we will continue to accumulate data. On labour, for instance, we are going to have a wealth of numbers and data, and intelligence, when collective bargaining agreements and annual negotiations in 2024 will be completed. That is way into 2024. That is only “a for instance.” Even having a discussion on a cut is totally premature. For the moment, what we are saying is that we have to be steady, we have to hold. This is the decision of today. We are holding.
Your third question had to do with this sort of external tightening, which is not directly relevant to the fundamentals of the euro area economy, but which are tightening elements nonetheless because they directly impact long-term yields and long-term rates as well. That definitely is a spill over that we take into account and that is compounded with other elements that clearly are bringing inflation down.

You said that you are seeing strong transmission of your past rate increases to financing conditions. Can you say how much of the impact has yet to hit the real economy and then inflation?
And then secondly, a follow up on energy costs. I am trying to understand how you would react to another spike in energy costs, for example, as a result of conflict in the Middle East. Would you take the recent inflation episode as a lesson and immediately react to that or could you afford to wait for second round effects?

Interesting questions. I'll start with your second one, which is essentially have we learned anything from the last energy crisis, the impact it has on inflation directly and indirectly, and would we apply the same approach? This is work that is ongoing and that we will continue to do. But it is clear to us that it applies to a completely different economy today and an economy which has had an episode of very high inflation, an economy where the interest rates (on the deposit facility) are at a very high level of 4%, and an economy that has strong employment and which is weakening. We have to take all these factors into account to see how possible higher costs of energy would actually affect both GDP and inflation. And it is in the context of that assessment that we would respond accordingly. But be under no doubt, our determination is intact and our determination to bring inflation to 2% in the medium term is absolutely the same if not reinforced by the proximity of the destination.

On your first question: what we are seeing is a very strong transmission of our monetary policy in the banking sector in particular. And the financing of the economy as a result is directly affected, which in turn plays on to the reduction of inflation and the dampening of demand. I am sure you have seen the bank lending survey – those numbers are very striking in terms of both volume and rate transmission. We know that there is still more to come. So as is often the case with monetary policy, there is this transmission lag time. The assessment by our staff is that there is still more in the pipeline and more to come to affect the real economy. And the assumption is that it will continue to unfold throughout the end of 2023 and first quarter of 2024. One might argue that it’s going to last longer but we have already seen a significant transmission to the financing conditions. More is to come and if you look at, for instance, the housing sector, it is pretty obvious that there is transmission to the real economy. If you look at the volume of capital expenditure, of investment by corporates, there is a reduction. It’s not just the banks telling us that they will be more attentive to the risk and that they are reducing their flow of credit. It is also the corporates that are putting a brake on their investment because of the level of interest rates. That clearly results from the various corporate telephone surveys that we conduct and from the bank lending survey as well. So, both in the housing sector and in investment numbers that we have, it is transmitting to the real economy.

I would like to ask you a question on spread widening. Have you at all discussed the spread widening and especially the case of Italy? Italian spreads are now above 200 basis points. And I was wondering if this is a level the ECB is comfortable with or if it's considered to be a level of significant widening? My second question is on Greece. Are Greek bonds now back to the ECB's normality? That is, are they now eligible for every purchase programme, when and if they are ever activated again? And are you confident that the Greek economy can return to normality? That is where it was before the debt crisis, when it was rated A and A+?

Thank you very much for your two questions. Let me turn to Greece first and remind you that we only have one active purchase programme that is operating at the moment and that is the reinvestments that we conduct under the PEPP. Under APP, we don't do any reinvestment anymore, so there is no question as to which country is eligible or not eligible. So Greece was eligible to PEPP under a special waiver that had been decided at the time. The good news is that the waiver is irrelevant. Greece does not need any waiver. The Greek instruments are eligible to PEPP without any exceptions. So that's point number one. Point number two. Greece is now back to a pre-COVID situation and I speak under the control of my colleague and friend Governor Stournaras. But Greece is actually higher than the level where it was just pre-COVID. Comparisons are odious, but I will make an exception. Greece compares extremely well with other countries. I am saying that because we are in Greece. I am not going to comment any further on who is better because I don't want to comment on countries' specific situations. I look at euro area numbers. But we are here in Greece and Greece has demonstrated phenomenal recovery capacity and it is, if I recall, 10% above the pre-COVID level at this point in time now. So I don't know what is normal or abnormal, but I have to say that it's a stellar performance. Would you like to add to this? And then I'll come back to the first question.

Yannis Stournaras: I fully agree President with what you have said. On activity, we are about 10% higher than the pre-COVID situation. GDP growth is much higher than the average of the eurozone. Spreads are within a range that is quite normal. So, all in all, it's a success story as the President said. I do not deny that there is still a lot to be done until we get back to a rating of A+ as you said.

So on the first part of your intervention, let me remind you what we do. Our mission is price stability. We have defined it in our strategy review as inflation at 2% in the medium term. We are not at 2%. The best tools that we can use to return inflation to 2% are our interest rates, and this is what we are using. And I just want to mention that the fact that we are holding doesn't mean to say that we will never hike again. So, at this point in time, on the basis of the data that we have, we are confident that the deposit facility rate at 4% – or the three rates at the level they are – contribute substantially to bringing us back to 2% in a timely manner. But we are data dependent. The second point is that, in addition to our stance, we also have to make sure that there is proper transmission of our monetary policy throughout the whole euro area and to all countries in the euro area. And we have all the adequate tools in order to make sure that that happens.

Two questions from me. The first question is about central bank losses. So, we've seen this week that the Riksbank (I know Sweden's not in the eurozone) but the Riksbank has warned it will need SEK 80 billion from the government to repair its balance sheet. Do you expect any

eurozone central banks to need similar kinds of capital injections?
The second question is about PEPP reinvestments. What's your view on the various calls we've heard from members of your Governing Council to say that the end of those reinvestments could be brought forward? Do you think that would be a risky move?

Thank you very much for your two questions. On your first question, I will not go into the specifics of each and every national central banks because they are all in a different situation. Some of them are publicly-quoted institutions, others are not and there is no one-size-fits-all for the situation they're in. What I know is that, as the Eurosystem and as ECB, we have one mission and that is price stability and we do not have as a purpose to show profits or to cover losses and it would be actually wrong if our decisions were guided by our P&L accounts rather than for pure monetary policy purposes in order to bring inflation back to 2% in the medium term.

On your second point, as I said earlier, we have not discussed PEPP on the occasion of this meeting.

Do you think that given the vigour of the monetary policy transmission and the added uncertainty of the war between Hamas and Israel that you just mentioned, ECB economic forecasts might be a little too optimistic?

I'm tempted to give you an appointment for our next monetary policy meeting because obviously in December we will have a whole range of new projections, new numbers and, as is often the case, we revisit either up or down depending on the situation and once again, we're going to be purely data-dependent. What we know for a fact is that growth has weakened and if we look at PMI numbers for instance, they are not indicative of a very vigorous growth, which is why I have clearly indicated in the monetary policy statement that growth continues to be weak.

Coming back on the bank lending survey, what you mentioned several times, the economy basically stagnates. I mean, is there a risk? Are you worried that you've just been too far? Yes, the transmission will be slow, but you might have gone too far.

I can only repeat what we say and we actually repeat in the monetary policy statement which is that we believe that the three rates where they are, if kept for a sufficiently long period of time, will actually make the contribution that is needed, the substantial contribution that is needed, to return inflation to 2% in the medium term. What we did on the occasion of this monetary policy meeting was to compare the projections that we had in September when we made our decision, to the new data that came in including the inflation number, headline and core inflation, including the bank lending survey, notably, and the various flash estimates and PMI numbers to confirm the assessment that we had previously. Let's not forget our mission is to return inflation to 2% to make sure that inflation does not cut into purchasing power of people.

I would like to come back to the rising bond yields again, please. There is the point of view that the rise in bond yields helps the central bank in the transmission of the monetary policy, as financial conditions become tighter. On the other hand, there are also people arguing that it can become a risk for financial stability. Do you agree with both points of view? And do you think it can become more difficult for you to find the right balance in the future?

I'm going to share your question with the Vice President because he is the real expert on this panel on financial stability. But I just want to again remind you of what I said about the rising bond yields. This is a movement that originated outside the euro area. It is not directly related to the fundamentals of the euro area and it is different but we are facing the same circumstances that we feared back in March at the time of the various regional banks and Silicon Valley banks and Signature and First Republic collapses where again there was spillover and the fear of more of it. This is something that clearly impacts our own rates and we take that into account.

Luis de Guindos: In a couple of weeks, we are going to release our Financial Stability Review (FSR). The FSR is the document where we indicate the main financial stability risks that we have here in the euro area. The increases in yields is something that we are looking at very carefully. Why? Because the main risk that we have identified in the past, and continue to identify in the near future, is very high valuations of different kinds of assets. And we have seen that when you look at these valuations, not only of financial assets as the President indicated before, we refer as well to the real estate market, the increase in yields can give rise to an important correction. So this is something that we are taking into consideration very, very closely and simultaneously all the factors such as the higher yields can have an impact mainly on the non-bank financial intermediaries. There we have seen that there is a concentration of potential vulnerabilities in terms of liquidity risks or liquidity mismatches in terms of credit risk. And these situations that you have, an important and pervasive increase in yields, can give rise to additional problems for this part of the financial system that is not totally isolated from the rest of the financial system. It has important liaisons and links with the banks. So the increase in yields is something that we are considering very closely and we will make a lot of comments with that respect in our Financial Stability Review about the potential impact that this might have in terms of financial stability.

Now that Greek bonds are eligible as you said, would they be included in your APP portfolio? Suppose you would restart the reinvestments, that's for sure.

And the second question: once upon a time, I would like to say the concept of saving was very important but in most of the euro area, like in Greece, deposit rates are almost zero and of course well below inflation, while lending rates have increased considerably. How do you comment on that and what can be done to change this situation?

Thank you very much for your two questions. On the first one, I'm tempted to tell you that I don't want to deal with the hypotheticals. We are in a process of fighting inflation, of bringing it to 2% using predominantly the interest rates, and ancillary, additional components that come as a complement such as the gradual reduction of the balance sheet as we have seen as a result of TLTRO reimbursements as a result of non-reinvestment of APP but I'm not going to have the hypotheticals about “what if” after tightening...Suffice to say that Greece is today eligible to the PEPP without any waiver, so it’s pari passu, everyone in the group, the 20 Member States are in the same situation from that perspective. You asked me about the rates and the obvious gap between the lending rates by banks to corporates and to households and the remuneration of deposits. Our job at the ECB and at national central banks is to set the rates at which banks and other institutions finance themselves. Our job is not to set the rates at which they lend – we hope that they transmit that properly because that's part of the transmission mechanism – nor the rate at which they remunerate deposits. And this is an issue that occurs in several euro area countries to which solutions are brought by either the authorities or by the power of consumers themselves or by the competition authorities, but this is not an area where the ECB or the national central banks can take action.

Madam President, you're a few days away from finishing the first half of your mandate. I was wondering if there's anything you regret from these four years and also if there's anything that makes you or has made you especially proud. A second question if I may. In Spain, the political parties are trying to form a government have proposed extending the new extraordinary bank taxes and when these taxes were announced, the ECB published an opinion advising against it. Should we expect another opinion or have you got anything to say about this topic at all?

Thank you for your personal question and rest assured that I have no regret.

You know what happened today: one of our members after 12 years of loyal and good services finished his term on the Governing Council, and it was his very last Governing Council meeting. The level of warmth, of emotion, of acknowledgement that was demonstrated to him and his response reminded all of us around the table that sometimes we disagree. By the way, we had an unanimous decision on this occasion. While we disagree on occasion, because there is this common drive for delivering on the mission, we have a quality of debates, of exchanges, of different views, we try to convince each other on occasions, and we sometimes manage; that is something that is to be cherished and, in a world where, for dissenting opinions, people go into totally unconsensual and irrational directions, it's a gem.

On the tax, Vice President.

Luis de Guindos: our assessment on bank taxes is well known. We have always said that these kinds of levies, these kinds of taxes should not impair lending, should not impair credit growth, and should not damage the solvency of the banks. That was the recipe included in our opinions for taxes that were approved in the case of Lithuania, Spain, and Italy. In the case of Italy, we had different versions [of the Decree Law] and the final one was more reasonable in that terms because they indicated that if they increase the capital buffers then the tax will be reduced. This is the approach. I don't know what's going to happen with the Spanish case, whether it's going to be extended or not. But the principle of our assessment with respect to this kind of taxation is quite clear.

Some people speculated that we've seen the height or the peak of the current interest cycle. Can we interpret this from today's decision or meeting or is still everything open? And the second question you have already answered partly, can you give us a little bit of insight of the debate today? From the protocols of last meeting, one can get the impression that the differences between the different groups of the Governing Council may have perhaps been a bit stronger than in the past. Is this interpretation right?

Typically when you reach by unanimous consent a decision, you don't have a widening of the differences. Together with colleagues who have been participating in all these hours of discussions here in Athens, I can assure you that there was a general well-shared assessment of the current situation, the judgement that we have made and the monetary policy decision we took which, after 10 different hikes over the last 15 months, is for the first time a hold. Sometimes inaction is action and a decision to hold is actually meaningful and was taken by total agreement of all governors and members of the Governing Council this morning. If any of you wanted to add to that, but I think you have either misinterpretation or strange information from inside our discussion. We were inside the rooms and I can assure you that it was strong. Do you want to add something Yannis?

Yannis Stournaras: I fully agree with what you said. It was a unanimous decision.

And as to your question on peak, I'm not going to pass a judgement to say that we are at peak. We are data dependent and we are going to meeting after meeting after meeting, assess on the basis of the three criteria of the inflation outlook, of the underlying inflation and the strength of our monetary policy transmission, whether or not our interest rates are delivering sufficiently in order to help us reach the 2% medium term inflation.

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CONTACT

European Central Bank

Directorate General Communications

- Sonnemannstrasse 20
- 60314 Frankfurt am Main, Germany
- +49 69 1344 7455
- media@ecb.europa.eu

Media contacts